

Everflow Water response to 'PR24 and beyond' consultation (July 2021)

Summary response

We are proud to be part of the largest retail water market in the world; the largest independent water retailer that has grown through switching; and one of the fastest growing companies in Europe.

We are pleased to have been invited to comment on the 'PR24 and beyond' consultation.

Our principal view is really a concern that the water retail market is not being given adequate consideration in Ofwat's overall price review process. MOSL recently calculated that non-households represent a third of market consumption in England and Wales. While Ofwat has published a highly detailed consultation about delivering its vision for the wholesale sector through the upcoming price review, we are disappointed that Ofwat has (not yet) published its vision for the retail sector price review. We were pleased when Ofwat announced that a retail price review would begin in autumn 2021, but we would urge Ofwat to engage with the market on its vision for this and to ensure that the price reviews across the wholesale and retail market are aligned.

The retail market was initially designed by industry experts at the time (regulators and wholesalers), and has then been allowed to develop relatively independently for a period of a few years. We support that this was the right approach for the market's initial few years. However, since 2017, serious issues have emerged which are impacting on the development of the competitive market.

- Delivery of outcomes for customers and the environment is heavily impacted by the market design and level of wholesaler influence and control. There is fundamental misalignment of incentives, influence and responsibility between wholesalers and retailers.
- It has been demonstrated that the majority of retailers are unable to make a profit due to price caps being set below the efficient level. Price regulation affects the whole market; not just where price caps officially apply.
- The impact of Covid-19 has exacerbated the effects of the above.
- The market is now increasingly unattractive to investors and new entrants.
- This will reduce the scope for innovation to facilitate delivery of customer and environmental outcomes.

It's now high time that the retail market is reviewed, but we are increasingly concerned that this review will be cursory, and it is unclear how the wholesale and retail price reviews will fit together. Both price reviews will need to consider and address the issues listed above. We are even more concerned by the possibility that the issues in the retail market may be reviewed mainly through the wholesale price review, and that this may undermine competition. For example, this particular consultation raises the possibility that wholesalers may be given a greater obligation (and funding) to deliver water efficiency in the non-household sector through PR24. We believe this would undermine the development of competition in delivering water efficiency services through the retail market.

Ofwat has a duty to promote competition and in order for the water sector to achieve its goals, the retail market needs to develop to maturity. We would like to deliver so much **more value** for customers and the environment. We think the PR24 themes/framework goals are right for the sector, but we believe that water retailers have the capability and ambition to play a bigger role in delivering them.

We are keen to engage with the PR24 price review, as we acknowledge it has an important part to play in resolving issues in the water retail market, and of course it is critical to the development of the wider water market. Not all of the questions in the consultation are relevant to the retail market, so we have responded only where appropriate and from a retail market perspective.

2. Ambitions for PR24

Q2.1: Do we agree that the themes Ofwat have suggested for PR24 are appropriate for England and for Wales?

- An increasing focus on the long-term
- Delivering greater environmental and social value
- Reflecting a clearer understanding of customers and communities
- Driving improvements through efficiency and innovation.

We support these themes for the sector as a whole. We support the UKWRC response which outlines how these themes relate to the retail market.

Q2.2: Do we have comments on the considerations Ofwat have identified as relevant to the design of PR24?

We agree that clarity around future regulation is important. The retail market needs that too; and there needs to be greater recognition of the interaction between regulation of the wholesale and retail markets.

We agree that simplification of the price review process is in all stakeholders' interests.

We would question whether reflecting regional and national diversity is efficient. As a national retailer, we are concerned about whether this could create barriers and lead to increased complexity for our customers – particularly those with multiple sites. We are keen to support efforts aimed at creating a more consistent market for customers.

3. How Ofwat regulates

Q3.1: How can Ofwat best regulate the water sector to deliver value for customers, communities and the environment? Do we agree, or have comments on, Ofwat's suggestion to maintain their 'building block' approach based on outcomes, costs and risk and return?

Q3.2: To what extent is greater co-ordination required across the sector? In what ways might Ofwat promote better co-ordination across companies and with other sectors, and how might this benefit customers?

We believe that greater coordination is needed between the wholesale and retail markets, and this includes greater coordination in the regulation of the wholesale and retail markets to ensure the water sector as a whole can deliver value for customers and the environment. Responsibility needs to be aligned with incentives and influence, so that each party is enabled to deliver its part. Fundamental changes to the market design will be needed to achieve this. For example, the provision of accurate and timely consumption data is essential to customer service and to water efficiency. Retailers have responsibility for this in the non-household market, but limited influence over resolving metering issues as the wholesaler owns the asset base. We believe that meter ownership is a key issue that needs to be resolved through the upcoming wholesale and retail price reviews.

We agree with Ofwat that appropriate incentives need to be implemented to encourage wholesalers to support the retail market and delivery of outcomes for non-household customers. Further embedding R-MeX, which has already been developed, would be a logical step in this direction. This should include specific elements on speed of response for bilaterals, data improvements and cooperation with market improvement work. For example, as a national retailer without a regionally based relationship with any one wholesaler, we'd like to see greater focus on standardisation so that customers experience the benefits of one efficient market.

4. Increasing focus on the long term

Q4.1: What are our views on the need for greater focus in companies' regulatory business plans on how they will deliver for the long term?

Q4.2 What should long term strategies cover? Would a common approach be helpful?

We agree that wholesale service provision is a long term business, and that planning should therefore focus on the long term.

We support the need for long terms strategies, as long as these are really meaningful. We support the use of a common approach. The plans should recognise the non-household market's future needs and align with long term planning for the retail market. The retail market lacks a long term plan at present but we are keen to support the development of a strategic plan for the market.

Q4.7: What are our views on how Ofwat could provide clarity over the long-term regulatory framework?

We would like to have clarity over the long term regulatory framework for the sector – including both the wholesale and retail markets. In the retail market, we are keen to see a clear roadmap to full retail separation and the lifting of price caps, which will no longer be necessary in a fully

functioning competitive market. We would like better visibility of when to expect REC reviews and how this will fit with wholesale price review timescales.

We note that Ofwat intends to retain its five-year PR periods, as staging posts within a long-term context to hold companies to account for historic promises and allow greater long-term investment. We would like to see a similar commitment for the business retail sector.

We fully support Ofwat's use of markets, although greater oversight will be needed in the retail market in the coming few years to ensure that it matures into a fully functioning market.

Q4.8: Are there barriers to water companies changing how they deliver their core functions to deliver greater environmental and social value? How can Ofwat address any barriers?

Confusion of roles and responsibility along with misaligned influence, incentives and responsibility in certain areas makes it difficult for both wholesalers and retailers to deliver outcomes for customers and the environment.

Non-household meter responsibility, ownership, maintenance/repair and even meter reading capacity all still sit mostly with wholesalers yet it is a key to retailers' delivery of outcomes for customers and the environment.

The delivery of water efficiency in the non-household market has also been affected by a lack of clarity around the role and responsibility of wholesalers and retailers.

Looking further ahead, retailers are now the primary point of contact for non-household customers. However, there are many situations in which the wholesaler is really the point of contact for the customer's issue or reason for interaction. In a mature and fully functioning market, retailers could be handling much of the customer facing service including incident and event communications; and promoting customer participation to support a range of water and wastewater service objectives.

5. Strengthening incentives

Q5.2: Should Ofwat consider adopting a more light-touch approach at PR24 for companies with a strong track record of delivery during the PR19 price review period? If so, what factors should Ofwat consider in their assessment and why?

We are not convinced that past performance is a strong indicator of future performance. Our experience is that wholesale company performance is inconsistent both between and within wholesalers and over time and they need to be held to account.

Q5.7: Which areas should Ofwat be considering targeted challenges for at PR24, and why?

We strongly disagree with Ofwat setting a targeted challenge for wholesalers to deliver greater water efficiency among business customers.

This would undermine the potential for successful competition in water efficiency service delivery in the retail market. The sector needs more certainty on where responsibility for this lies, and appropriate influence and incentives are needed to support this. As retailers own the relationship with business customers and behaviour change requires a high level of customer engagement, we believe that Ofwat should explicitly state that retailers are responsible for this and not incentivise wholesalers to overstep their remit. Water efficiency was one of the core objectives for opening the retail market, so we do not see how including this as a targeted challenge for wholesalers at PR24 would align with that.

It is also fundamentally important to recognise that customers are central to delivering water efficiency and need to be directly incentivised. We are not convinced that customers would support wholesalers or retailers being given a stretching target for reducing customer consumption; clear support from customers would be needed.

Furthermore, while water efficiency investment has historically been focused on the use of water saving devices the future of water efficiency will depend more on behaviour change which is more uncertain. There is therefore a risk that planning to maintain a supply-demand balance through ambitious water efficiency plans could actually reduce resilience rather than increase it.

Q5.8: Should Ofwat use innovation specific incentive mechanisms at PR24? If so, what would these be, and what would they add in addition to the other mechanisms outlined in this chapter?

We agree that specific funding for innovation will encourage greater innovation in the industry. However, Ofwat has still not yet opened up the Innovation Fund to retailers, despite our contributing towards the fund through our wholesale charges (approximately a third of wholesale charges come from the non-household sector).

6. Reflecting customers' preferences

Q6.1: What are our views on the merits of Ofwat's proposals for a collaborative approach to standardised and/or nationwide customer research to inform company business plans and their determinations?

We agree with the need to standardise customer research and also look at national customer research to complement individual company research. We are already working together on collaborative non-household customer research through engagement with industry groups.

Retailers could facilitate direct non-household customer research. We should also comment directly because we are the customers of wholesalers and understand the impact wholesalers have on our own customers in a way that our customers will struggle to understand or communicate. We also have experience of various wholesalers' services so we can validly compare.

Q6.4: What are our views on Ofwat's proposals for customer challenge of business plans and assurance of customer engagement?

We think retailers could participate in the proposed PR24 Challenge Panel. We believe this to be an important governance structure. There may be a case for a specific retail market focussed sub-group, but a retailer voice should also be included in the main group.

8. Design and implementation of price controls

Q8.1: Do you agree with, or have any comments on, our general approach to the design and implementation of controls, i.e. to retain separate controls with the same broad structure as at PR19, but with improvements to our implementation?

Q8.2: Do you agree with, or have any comments on, our proposals for specific parts of the value chain, i.e. for water resources, developer services, residential retail and business retail in Wales?

We would like to see greater alignment with and consideration of the retail market.

9. Outcomes

9.1: What kinds of performance commitments should we include in the price review? What outcomes require financial incentives for all companies for the foreseeable future?

Wholesale companies are clearly strongly motivated by their Performance Commitments; especially where significant financial incentives are attached. It is therefore important that the measures used reflect customer priorities, and are collectively balanced across different priority areas.

From a retailer point of view, there is a need for stronger incentives towards support for the development of competition in the non-household market. An equivalent measure to C-MeX and D-MeX would help to drive better outcomes for non-household customer service. We are less convinced by the notion of B-MeX than R-MeX. We question whether it would be helpful to incentivise wholesalers to directly measure non-household customer satisfaction because they do not own the relationship. R-MeX (or an improved, more customer-focussed version) would be more appropriate as a common PC with ODIs attached.

As we said in answer to question 5.7, we do not support a PC for or including non-household water efficiency as this will simply encourage wholesalers to work directly with non-household customers instead of retailers. R-MeX could partly measure wholesale support for non-household water efficiency efforts. We do suggest that the subject of how water efficiency is delivered in the non-household sector is considered and covered in both the wholesale and retail price reviews.

11. Risk and return

For the retail market, the balance of risk and reward, including the allocation between wholesale and retail, absolutely needs to be addressed. As the Covid-19 pandemic highlighted, retailers bear a level of financial risk that makes the market as a whole vulnerable to economic shocks.

The Economic Insight review of the retail market showed that much of the market is operating at a loss. The pandemic has worsened the financial resilience of retailers, posing a real risk of multiple retailer failure. This is a risk for wholesalers too as systemic failure would lead to a loss of income impacting on their ability to deliver operationally and on investment programmes.

If water retail companies are operating at a loss, they are also unable to offer discounts to customers to encourage them to switch, which reduces competition.

The issue may in part be resolved through assessing the allocation of costs between wholesale and retail services. For this reason, it concerns PR24 as well as the retail price review.